

ANPR Response to Corporate Credit Union System

St Vrain Valley Credit Union
Longmont, CO 80501

Payment System Proposals

1. Should payment system services be isolated from other services to separate the risks?
 - a) If so, what is the best structure for isolating these services from other business risks?

Response: No. Separating business lines into separate entities could create greater risks and higher costs for NPCUs. To attempt to eliminate risk, as opposed to manage risk, will lead to significantly greater costs for NPCUs and will eliminate options for NPCUs to conduct their business in a cooperative system model. We do not want to return to the days where we relied on for-profit banks for the services that we now receive from our Corporate. Credit Unions need Corporates as our Member-owned, not-for-profit aggregator, in order to gain economies of scale related to investment, liquidity, and payment systems needs.

2. Should there be a charter that strictly limits corporates to operating a payment system only?

Response: No. This option has the potential to be more costly.

3. Are there sufficient earnings potential in offering payment systems to support a limited business model that is restricted to payment systems services only?

Response: No. Moving payment systems into a separate entity could increase overhead costs and force that inefficiency back to the NPCUs unless more consolidation occurred. Separation would lead to duplication of overhead, as well as redundancy requirements and controls, making this option very costly for NPCUs.

Liquidity and liquidity management proposals

1. What steps should be taken, and by whom, to preserve and strengthen corporates' ability to offer liquidity services?

Response: Liquidity management is primarily the responsibility of NPCUs, our management and Board, and secondarily, at the Corporate level as a safety mechanism. My Corporate provides emergency liquidity back-up to my Credit Union. Please consider allowing our Corporates to borrow directly from the Central Liquidity Fund!

2. Should the NCUA consider limiting a corporate's ability to offer other specific types of products and services in order to preserve and defend the liquidity function?
 - a) What specific types of products and services should corporates be authorized to provide?

Response: No. Corporates must be permitted to have a full spectrum of cooperative products and services. NPCUs should not be limited to for-profit options often run by our competitors at profits that are used to support stockholders and the bank's stated goals to put Credit Unions out of business.

Field of Membership Issues

1. Should the agency return to defined FOMs to address what they perceive as risk associated to expanding FOM?

Response: No. My Credit Union should be allowed to join any Corporate. An alternative to limiting Corporates' FOM is to require that all NPCUs capitalize any Corporate that they use for investment purposes.

Expanded Investment Authority

Currently, Part 704 provides an option by which corporates meeting certain criteria can qualify for expanded investment authority.

1. Does the need for expanded authorities continue to exist?
 - a) If so, should NCUA modify the procedures and qualifications by which corporates currently qualify for expanded authorities?

Response: The need for expanded authorities exists. Corporates with the highest investment authorities have the lowest capital levels. There is a need to align capital requirements with risk.

- b) If so, what should the new standards be?

2. Should NCUA reduce the expanded authorities available?
 - a) If so, which ones?

Response: No. Credit Unions are already more restricted than banking counterparts, yet we are quickly moving to the same capital standards as banks. This furthers the competitive disadvantages of our cooperative model.

Structure: two-tiered system

The corporate system is made up of two-tiers: a retail network of corporates that provide products and services to NPCUs, and a single, wholesale corporate (U.S. Central) that exclusively services the retail corporates.

1. Does the two-tier corporate system in its current form meet the needs of credit unions?

Response: This two-tier system has functioned well, until now. Allowing Corporates to borrow from CLF for liquidity needs could have helped Corporates weather this storm. Increased capital standards will help Corporates withstand future problems.

2. Is there a continuing need for a wholesale corporate credit union?
 - a) If so, what should be its primary role?

3. Should there be a differentiation in powers and authorities between retail and wholesale corporates?

4. Does the current configuration result in the inappropriate transfer of risk from the retail corporates to the wholesale corporate?

Response: There should be a better balance between risk and capital requirements as noted earlier, and the Corporate Network may need additional capital.

5. Should capital requirements and risk measurement criteria (e.g., NEV volatility), be different from those requirements that apply to a retail corporate credit union?

Response: Safe and measured requirements should always be maintained.

Corporate Capital

NCUA is considering revising various definitions and standards for determining appropriate capital requirements for corporates. These changes would bring the corporate capital requirements more into line with standards applied by other federal financial regulators.

Another issue under consideration is whether to require a certain level of contributed capital from any natural person credit union seeking either membership or services from a corporate.

Response: Natural person Credit Unions should be required to maintain a contributed capital account with any Corporate they do business with.

Core Capital

Under the current rule, core capital is defined as retained earnings plus paid-in capital.

1. Should the NCUA establish a new capital ratio that corporates must meet consisting only of core capital, and if so, what would be the appropriate level to require?

Response: Risk-based capital, as has been suggested by Corporates several years ago, should be considered again by the Agency. It appears the NCUA is moving to a BASEL standard. Caution is required, because BASEL organizations have many more authorities than Corporates. Holding Corporates to the same capital levels, without permitting them to have the same level of authorities, will lead to underperformance and disintermediation, which could lead to the demise of the Corporates and many credit unions that Corporates support.

2. What actions are necessary to enable corporates to attain a sufficient core capital ratio?

Response: NCUA should allow Corporates to obtain secondary capital.

3. What would be an appropriate time frame for corporates to attain sufficient capital?

Response: Sufficient time must be allowed for Corporates to build capital.

4. What is the appropriate method to measure core capital given the significant fluctuation in corporate assets that occur?

Response: Risk-based capital would assist Corporates in managing capital based on balance sheet risk while dealing with asset fluctuations that can increase or decrease quickly because of NPCUs' liquidity needs. As a liquidity provider and a cooperative,

Corporates must be able to grow and shrink the balance sheet to meet the needs of their Members.

5. What is the correct degree of emphasis that should be placed on generating core capital through undivided earnings?
6. Should there be a requirement that a corporate limit its services only to members maintaining contributed core capital with the corporate?

Response: Yes. This change in regulation will keep the playing field level and require NPCUs to determine the number and size of Corporates (let the market decide winners and losers; not the regulators or insurers). The NCUA should also assure that all Corporates have similar capital standards in terms of contractual conditions based on investment authorities utilized and other products provided.

7. Offer any other suggestions or comments related to core capital for corporates.

Risk-based capital and contributed capital requirements

1. Should NCUA consider risk-based capital for corporates consistent with that currently required of other federally regulated financial institutions?

Response: Yes. However, there must be caution to make other business authorities consistent. If risk-based capital requirements are applied, then commensurate business activities should be allowed to avoid an unfair competitive environment due to charter differences between banks and credit unions.

2. What regulatory and statutory changes, if any, would be required to effectuate such a change?
3. Should a natural person credit union be required to maintain a contributed capital account with its corporate as a prerequisite to obtaining services from the corporate?

Response: Yes. As noted earlier, this would assure that competition between Corporates would be limited to those who support the Corporates through maintaining capital versus those that are only looking to “cherry pick” rates and services.

4. Should contributed capital be calculated as a function of share balances maintained with the corporate? What about using asset size?

Response: There are many ways to calculate this requirement, and caution must be exercised to avoid unintended consequences. The formula should be simple to manage and explain. The regulator should allow various approaches to meet each Corporate’s business model. These are contractual arrangements between NPCUs and Corporates. The NCUA may need to set minimum standards.

Permissible Investments

NCUA is considering whether the corporate investment authorities should be constrained or restricted. Presently, corporates have the authority to purchase and hold investments that would

not be permissible for natural person FCU members under Part 703 (or, in some cases, outside of what is authorized for a state chartered credit union).

1. Should the NCUA limit corporates' investment authorities to those allowed for NPCUs?

Response: No. This would severely restrict NPCUs ability to earn any competitive rate on their investments as they do not have the authorities that Corporates have. And, it is very unlikely that we would be granted these authorities due to rigorous requirements that the NCUA places on Corporates. The cooperative concept of aggregating authorities and risk is a good one that can be improved by aligning capital and risk taking at the same level. The restriction of authorities to equal NPCUs' authorities could lead to the demise of the Corporate System as capital retention and the same powers would provide no benefit to a cooperative model. The alternative, if this is accomplished, would be to increase authorities at the NPCU level so they can remain competitive. This could increase the risk to the insurance fund, and increase cost to NPCUs.

2. Should the NCUA prohibit certain categories of, or specific, investments?

Response: No. Care should be taken to possibly expanding some authorities, while placing a framework of risk diversification and mitigation, as should be done with any new rule.

Credit Risk Management

1. Should the NCUA limit the extent to which a corporate may rely on credit ratings provided by Nationally Recognized Statistical Rating Organizations (NRSROs)?

Response: No. The NCUA, other national regulators and Congress should instead focus on holding the NRSROs accountable for their lack of in-depth analysis, the lack of a 100-year event stress test and eliminate the potential conflicts rating agencies have with regard to payment for services. It is inconceivable that entities like Corporates would be required to develop these complex tools and acquire the resources necessary to make assessments that we should rely on them to provide. Fix the problem at the source and do not generate additional or new problems.

2. Should the NCUA require more than one rating for an investment, or require that the lowest rating meet the minimum rating requirements of Part 704?

Response: Multiple models give broader views and are often helpful.

3. Should the NCUA require additional stress modeling tools in the regulation to enhance credit risk management?

Response: Yes. Additional testing should be considered.

4. Should Part 704 be revised to lessen the reliance on NRSRO ratings?

Response: No. NRSROs should be regulated as closely as financial institutions and those requirements strengthened.

Asset Liability Management

Under past rules, the NCUA required corporates to perform net interest income modeling and stress testing. The agency is considering re-instating that requirement in light of the current market. Alternatively, the agency may consider some form of mandatory modeling and testing of credit spread increases.

1. Should the NCUA require corporates to use monitoring tools to identify these types of trends, including specifically comments about tangible benefits, if any, which would flow from these types of modeling requirements?

Response: Yes. Increased testing and modeling will be beneficial.

Corporate Governance

1. Should the NCUA require that a director possess an appropriate level of experience and independence?

Response: The NCUA should establish a regulation for a Board to have an active policy on experience levels and training requirements and hold them accountable for compliance. Independent Boards as modeled in the for-profit sector of financial institutions did not prevent the financial crisis.

Regarding independence, the NCUA should not require Board members to be independent of their NPCU or Corporate Board. This is a cooperative system and should maintain that governance of “for the people and by the people.” The NCUA should however, allow a NPCU or Corporate Board to retain outside directors if they so choose.

2. Should the agency set term limits, allow compensation for corporate directors, and requiring greater transparency for executive compensation?

Response: These are decisions that should be determined by each Corporates’ Board of Directors. Term limits are gaining popularity in the CU system and should be considered more a norm than an exception, but should be determined by a Board of Directors. Possibly, Corporates might be able to attract qualified talent easier if Corporates were permitted to compensate directors.

No one is interested in publicizing the salaries of Corporate or Credit Union CEOs. Public disclosure of CEO compensation would not solve any of the problems that NPCUs or Corporates face today.

3. Is the current structure of retail and wholesale corporate credit union boards appropriate given the corporate business model?

Response: There should be no limitations on obtaining the best available Board talent, except as the governance structure would require.

4. Should NCUA establish more stringent minimum qualifications and training requirements for individuals serving as corporate credit union directors?
 - a. If so, what should the minimum qualifications be?

Response: There could be a national standard for minimum training hours for both NPCUs and Corporate directors.

5. Should the NCUA establish a category of “outside director,” (persons who are not officers of that corporate), officers of member natural person credit unions, and/or individuals from entirely outside the credit union industry?

- a. Should the NCUA require that corporates select some minimum number of outside directors for their boards?

Response: The addition of outside directors cannot be demonstrated to improve the safety and soundness of a financial institution.

6. Should US Central be required to have some directors from NPCUs?

Response: This would be an acceptable option, and could provide perspective.

7. Comment is also sought on whether corporate directors should be compensated, and, if so, whether such compensation should be limited to outside directors only.

Response: Compensating Directors without minimum qualifications would not be effective. If compensation is provided for in the regulations, it should be for all directors and not limited to only outside directors.